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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**02/10/05**	Bill No:	**AB 62**
Tax:	**Property**	Author:	**Strickland**
Related Bills:	**AB 185 (Plescia)**		

BILL SUMMARY

This bill would increase the amount of the homeowners' exemption for "first time" homebuyers.

ANALYSIS

Current Law

Article XIII, Section 3(k) of the California Constitution exempts the first $7,000 of assessed value of an owner occupied principal place of residence. This exemption is called the "homeowners' exemption." Section 25 of Article XIII requires the state to reimburse local government for the resulting property tax revenue loss.

Existing law, pursuant to Section 3 of Article XIII, authorizes the Legislature to increase the homeowners' exemption if:

- local governments are reimbursed for the revenue loss; and,
- benefits to renters, currently provided via the renters' income tax credit, are increased by a comparable amount.

Section 218 of the Revenue and Taxation Code specifies eligibility for the exemption and sets the exemption at $7,000.

Proposed Law

This bill would amend Section 218 of the Revenue and Taxation Code to increase the homeowners' exemption for "qualified purchasers" for the first nine years of ownership as noted below. A "qualified purchaser" is a person who did not own a dwelling that qualified for the homeowners' exemption in the two prior years.

Year	Amount Exempt
1-5	25% of Assessed Value
6	20% of Assessed Value
7	15% of Assessed Value
8	10% of Assessed Value
9	5% of Assessed Value
10	$7,000

This bill would also state the intent of the Legislature to provide a comparable benefit to qualified renters.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Background

Many property tax reform proposals were advocated in the 1960's and 1970's because at that time property taxes were based on a property's actual market value. The law then required property to be reassessed on a cyclical basis. These periodic reassessments resulted in substantial property tax increases due to rapidly escalating real estate values similar to the real estate market in recent years. To provide some measure of property tax relief, the homeowners' exemption was created in 1968 via a constitutional amendment. (Proposition 1-A; SCA 1 and SB 8, Stats. 1968). The exemption was equivalent to $3,000.[1] In 1972, legislation was passed to increase the exemption to its current equivalent level of $7,000 beginning in 1974.[2] (SB 90, Stats.1972)

Numerous bills were introduced in the Legislature between 1972 and 1978 to increase the exemption. Apparently, these bills were rejected, in part, because some viewed the creation of the homeowners' exemption as a temporary means of providing property tax relief, the benefits of which would erode over time due to inflation. Some argued instead that a fundamental change to the property tax system was needed to contain rapidly increasing property taxes.

Ultimately, the property tax reform proposal adopted was Proposition 13 (Article XIIIA of the California Constitution). Approved by the voters in November 1978, it rolled back real property values to 1975 market value levels and limits annual increases in assessed values thereafter to the rate of inflation, not to exceed 2%, as long as the property remains under the same ownership. Proposition 13 also limits the tax rate to 1%. Previously, each taxing agency could determine and levy its own rate and the statewide average tax rate was about 2.67%.

Under Proposition 13, property is reassessed to its current market value only after a change in ownership. Generally, the sales price of a property is used to set the property's assessed value and annual increases to that value are limited to the rate of inflation, not to exceed 2%. Thus, Proposition 13 established a new assessment value standard that requires property to be assessed based upon the market value of the property at the time it is acquired by the taxpayer, rather than the value it has in the current real estate market. For property owners, especially homeowners, the primary benefits of this assessment value standard is that future property tax liability is determinable and annual increases are modest.

Related Bills. Since Proposition 13, numerous bills have proposed increasing the exemption as summarized below. A variety of methods have been considered including:

- increasing the exemption by a flat amount,
- varying the exemption according to the year of purchase,
- indexing the exemption for inflation, and
- increasing the exemption for certain classes of persons.

[1] The actual amount was $750 of assessed value; however, at that time, property was assessed at 25%, rather than 100%, of value.
[2] The actual amount was $1,750 of assessed value.

In 2002, the initiative process was used for the first time to attempt to increase the amount of the exemption and the renters credit via a direct vote of the people, but not enough signatures were obtained to place the measure on the ballot.

Bill	Year	Author	Proposal
AB 2357	2003-04	Plescia	Increase to $10,000 for over 62
AB 211	2003-04	Maze	Increase to $17,000 for over 62, disabled or blind
AB 82	2003-04	Dutton	Increase to $32,000, plus index for inflation
Initiative	Signature drive ended 11/6/02 – Not Pursued	Howard-Jarvis Taxpayers Assoc. & Bill Simon	Increase to $32,000, plus index for inflation
AB 1844	2001-2002	Mountjoy	Increase to $17,000 for over 62, disabled, or blind
SB 48	2001-2002	McClintock	Index for inflation by California CPI
SB 48	2001-2002	McClintock	Increase to $25,000, plus index for inflation
AB 218*	**2000-2001**	**Dutra**	**Increase for 1st time homebuyers**
AB 2288*	**1999-2000**	**Dutra**	**Increase for 1st time homebuyers**
AB 2158	1999-2000	Strickland	Increase to $8,750 for persons over 62
SCA 8	1999-2000	Johannessen	Increase to $20,000; delete renter's credit parity
AB 2060	1997-1998	Granlund	Increase to $20,000
ACA 43	1997-1998	Granlund	Increase to $20,000
ACA 5	1991-1992	Elder	Variable, according to assessed value
ACA 31	1991-1992	Frizzelle	Index for inflation by California CPI
ACA 47	1991-1992	Jones	25% exemption; no assessed value cap
ACA 3	1989-1990	Elder	Variable, depending on year acquired
ACA 9	1989-1990	D. Brown	25% exemption; $250,000 assessed value cap
ACA 31	1989-1990	Hannigan	15% exemption; $150,000 assessed value cap
ACA 55	1989-1990	Wright	Increase to $48,000
ACA 1	1987-1988	Elder	Increased to $25,000, plus index for inflation
ACA 25	1987-1988	D. Brown	25% exemption; $250,000 assessed value cap
AB 2141	1985-1986	Klehs	20% exemption; $50,000 exemption cap
AB 2496	1985-1986	Cortese	Increase in years with General Fund Reserves
AB 3086	1985-1986	Elder	Variable, depending on year acquired
AB 3982*	**1985-1986**	**La Follette**	**Increase for 1st time home buyers**
ACA 49	1985-1986	Elder	Variable, depending on year acquired

COMMENTS

1. **Sponsor and Purpose.** The author is sponsoring this measure to make homeownership more affordable for first time homebuyers by reducing the associated property tax burden.

2. **The Constitution Specifies the Minimum Amount of the Exemption.** The $7,000 amount specified in the Constitution is the *minimum* amount of the exemption. The exemption can be statutorily increased, as long as there is an equivalent increase in the amount of the renters' credit and local governments are reimbursed for property tax revenue losses. This bill includes legislative intent language to increase the renters' credit and reimburse local government.

3. **Exemption Amount Unchanged Since the Enactment of Proposition 13.** The homeowners' exemption was enacted in 1968 and increased to its current level in 1974. Despite numerous attempts, the exemption has not been increased in more

than 30 years. Arguments against increasing the exemption generally follow the line of reasoning that California property tax law, via Proposition 13, provides sufficient property tax relief and protections for homeowners. Opponents of increasing the exemption have also expressed concern over the fiscal impact of increasing the exemption since the state would be required to fully reimburse local governments for the revenue loss as well as provide a comparable increase in benefits to renters via the renters' state income tax credit.

4. **There is no maximum cap to amount of the exemption.** The amount of the exemption would vary according to the price of a home. Similar bills in prior legislative sessions included an assessed value cap to establish an upper limit to the amount of the exemption provided to a taxpayer.

5. **The definition of a "qualified purchaser" is broader than a "first time" homebuyer.** The enhanced exemption is available to any person who was not eligible for the homeowners' exemption in California for the prior two years. This includes for example:

   - **Out-of-State Buyers.** Persons moving to California from another state or country that previously owned a home.

   - **Prior Home Owners.** Persons who previously owned a home, but had not been in the real estate market for a two-year period.

   - **Rental Property Conversions.** Persons who currently rent or live with other persons and who currently own homes in California that are rented to others that subsequently transform that property into their principal place of residence.

6. **Technical Concerns.** The language defining the two-year period is not technically workable because persons can become eligible for and receive the homeowners' exemption as of their date of purchase via the supplemental roll, which is not driven by the lien date (January 1). The phrase "full value" should be replaced with "taxable value." (See §§51, 75.9, 110, 110.1 and 110.5) The homeowners' exemption was established pre-Proposition 13 when property was assessed at full value. Proposition 13 changed the definition of full value, and an exemption based on a percentage of "full value" could raise implementation questions as to whether the exemption should be 25% of current fair market value rather than assessed value (which is generally the factored base year value, but could be less pursuant to Section 51). Presently property is assessed at the lower of its fair market value or factored base year value.

   (a)(2)(B) For purposes of this subdivision a "qualified purchaser" is a person that, for the two-year period immediately preceding the ~~lien~~ date for which that person is eligible for the exemption authorized by this section, was not the owner of a dwelling that qualified that person for the exemption authorized by this section.

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   (c)(i) "For the first five years beginning on the <u>first</u> lien date <u>after</u> ~~for~~ which the qualified purchaser is eligible for the exemption authorized by this paragraph, the exemption is that amount equal to 25 percent of the ~~full~~ taxable value of the dwelling." (Conforming amendments would need to be made to the other provisions as well.)

7. **Supplemental Assessments.** Additional amendments would be needed to address the calculation of the increased exemption for first time homebuyers on the supplemental assessment roll.

8. **Ten Year Tracking.** Counties would incur costs in tracking the exemption and annually reducing the amount of the exemption.

9. **The State Subvenes Property Tax Revenue Loss from the Homeowners' Exemption.** The homeowners' exemption is the only property tax exemption for which the state fully reimburses local governments. The state also makes subvention payments to offset property tax reductions for open space and agricultural property that receives preferential assessment treatment under the Williamson Act at the rate of $1 per acre for non-prime land and $5 per acre for prime land.

10. **Related Bills.** AB 185 (Plescia) would increase the homeowners' exemption to $15,000 for persons over the age of 62 years.

11. **Chaptering Out Potential**. AB 18 (La Malfa) and AB 164 (Nava) related to specified disasters also amends Section 214.

COST ESTIMATE

The Board maintains the statewide database for homeowners' exemption claims to assure the accuracy of the state's reimbursements and to prevent duplicate claims within the state as required by Section 218.5. The Board may incur additional costs if a new database is required to track persons qualifying for the enhanced exemption and to respond to inquiries from assessors in determining if a taxpayer had been receiving the homeowners' exemption in another county. A detailed cost estimate is pending.

REVENUE ESTIMATE

This revenue estimate does not address the renters' tax credit provisions of this bill which are administered by the Franchise Tax Board

Background, Methodology, and Assumptions

Existing property tax law provides for a homeowners' exemption in the amount of $7,000 of the full value of a "dwelling," as specified. The state is required to pay subventions to local governments for the homeowners' exemptions to offset the resulting property tax loss. The state subvention reimbursement to local governments for the homeowners' exemption totaled $424.8 million in 2003-04 on 5.4 million claims. The total exempt values on these properties were $37,957,506,000. The average tax rate calculates to 1.119% ($424,786,000 / 37,956,506,000).

According to the California Association of Realtors (C.A.R.), a first time homebuyer is a person that has not owned a dwelling for at least 3 to 5 years. This person would be eligible for first time homebuyer assistance available through State and Federal housing programs. Since this definition is similar to the definition of "qualified purchaser" under this bill, for the purpose of this estimate we used information compiled by C.A.R. In 2004, the number of first time homebuyers fell to an all time low of 26% of all homes sold in any year during the 24-year history of the C.A.R. survey. Closed escrow sales of existing, single-family detached homes in California totaled 645,860 in December 2004, an increase of 1.4% from the December 2003 year-end total of 637,080. In 2004, detached homes comprised 78% of all sales. Thus, the number of all homes sold in 2004 was approximately 828,026 (645,860 / 78%). Also, in 2004, new housing permits topped 150,000. Under this bill, we estimate that 254,287 people will be qualified purchasers for this exemption in 2006 [(828,026 +150,000) x 26%].

We compiled information provided by C.A.R., and found that since 1995, the number of first time homebuyers has declined by an annual average of 6.9% of all homes sold. However, based on historical data, we estimate that the number of all homes sold will increase annually by 1.1%. Combining these amounts, we estimate that the number of people qualifying for this exemption for the first time will fall to 148,881 in tax year 2015.

The median home price in California for all single-family homes, for both detached homes and condominium/townhouses, increased to an all time high of $450,990 in December 2004, an increase of 21.4% from the December 2003 price of $371,520. According to C.A.R. in 2004 the median price of a home for a first time homebuyer was $369,320, or 81.9% of the median price of $450,990.

Over the last five years, the median price of homes has appreciated an average of 15.8%. However, in determining this estimate we used an annual appreciation rate of 5%. As determined above, we also assumed an annual decrease of 5.8% in the number of qualified buyers (-6.9% +1.1%).

In first year, state subvention reimbursement would increase by $242.8 million more than the amount the state would normally be required to reimburse local government for the existing $7,000 exemption. The exemption for a qualified purchaser will increase to $92,330 ($369,320 x 25%). In the fifth year of operation, this bill will result in an increase in the state's subvention reimbursements by $1.2 billion over the most recent FY 2003-04 reimbursements of $424.8 million. This reimbursement will increase by $1.6 billion in the tenth year of operation.

Revenue Summary

This bill will increase state subvention reimbursements to local governments by $242.8 million in the first full year of operation. The cumulative increase in subvention payments in FY 2015-16 will be $1.6 billion more than the FY 2003-04 reimbursement of $424.8.

The breakdown of the estimated cumulative increase in the homeowners' exemption subvention reimbursements for each of the first ten years is:

In millions			
Fiscal Year	Estimated Cumulative Subvention Reimbursement for qualified purchasers under this bill	Estimated Cumulative Subvention Reimbursement for qualified purchasers under current law	Net Cumulative Increase in Subvention Reimbursement
2006	$ 262.7	19.9	242.8
2007	522.7	38.7	484.0
2008	779.8	56.4	723.4
2009	1,034.2	73.0	961.2
2010	1,286.0	88.7	1,197.3
2011	1,482.5	103.5	1,379.0
2012	1,624.3	117.5	1,506.8
2013	1,712.2	130.6	1,581.6
2014	1,746.5	143.0	1,603.5
2015	1,747.8	154.6	1,593.2

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